State of the art report: The politics of employment-friendly welfare reforms in post-industrial economies

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Abstract: The transition to post-industrialism has generated a range of new tensions between welfare arrangements and labour market performance, which confront today's welfare states with new challenges for employment-friendly recalibration, such as flexicurity, activation and work-care conciliation. Hence, the question of whether, how and to what extent current welfare states are able to adapt to the conditions and needs of post-industrial labour markets has become a major issue in recent welfare state research. This article identifies and discusses key debates in this literature on the politics of employment-friendly reforms. It first focuses on the general capacity for reform in mature welfare states and then discusses regime-specific reform politics, since post-industrialism confronts different welfare regimes with very different challenges. For each regime, the article proposes a range of research frontiers and open debates which we consider particularly relevant and fruitful avenues for future theorizing and research.

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State of the art:
The politics of employment-friendly welfare reforms in post-industrial economies[1]

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Introduction: goals and outline

This article identifies and discusses key debates in the literature on the *politics of employment-friendly welfare reforms in post-industrial economies*. The literature on the relationship between welfare institutions and labor market performance has shown that welfare states are not necessarily detrimental to economic performance[2]. If welfare institutions and labor markets are complementary, the effects may rather be positive. However, the welfare institutions that enhanced labor market performance in the industrial age may weaken this performance in a different, post-industrial context. An ample literature indeed shows that the transition to post-industrialism has generated a range of new tensions between welfare arrangements and labor market performance, which confront today's welfare states with new challenges for employment-friendly recalibration. Hence, one of the major questions in the political science welfare state literature of the past one or two decades has been whether, how, and to what extent current welfare states are able to deal with these challenges and to adapt to the conditions and needs of post-industrial labor markets. This literature is the subject of the present article.

The goal of this article is twofold: on the one hand, we present our reading of the literature on employment-friendly reform politics in mature welfare states. Both these politics and the literature that theorizes and analyzes them are evolving dynamically. Therefore, our discussion of the literature cannot be an exhaustive presentation of the topic, but rather provides an interim overview of the major research in this area. The second goal is to propose and discuss a range of current and new research frontiers and open debates, of which we think that they will strongly benefit to our understanding of the conditions of employment-friendly reforms in mature welfare states.

This article is structured as follows: A first part reviews the post-industrial challenges to mature welfare states and labor markets: globalization, de-industrialization and demographic changes. We then review a range of typical, post-industrial welfare-employment tensions resulting from these challenges. This provides us with an understanding of what the current literature defines as employment-friendly policy reforms: flexicurity, activation, work-care conciliation and social investments in human resources and skills.

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[2] The early Keynesian literature (Keynes 1986, Weir et al. 1988 etc.) argued that welfare states are actually a precondition for efficient economies and labor markets. Both capitalists and workers need certain guarantees in terms of stability, job and earnings security to work productively in the long run. More recent and specific studies focus on the effect of the total welfare effort on job performance (see e.g. Atkinson 1995, Kvist 2002), on the effects of wage coordination and wage moderation on employment (e.g. Calmfors and Driffill 1988, Pontusson and Swenson 1998, Mares 2006) or on the impact of the mode of welfare financing on job performance (e.g. Palme 1998, Deakin and Parry 2000 etc.).

The main part of the article then reviews our reading of the literature on the politics of these employment-friendly welfare reforms, focusing on actors, preferences and institutions. In section 2, we focus on the prominent institutionalist literature that deals with the general capacity for reform in mature welfare states: Can industrial welfare states be reformed in an employment-friendly way? What are the conditions for the implementation of unpopular "commodifying" reforms, and what are the factors that explain success or failure of post-industrial recalibration? In section 3, we focus more specifically on the regime-specific reform-politics, since post-industrialism confronts different welfare regimes with very different challenges. In this section, we review literature on the respective agendas, politics and reform determinants in Scandinavian, liberal and continental welfare regimes.For each regime, we then propose a range of research frontiers and open debates, which we think are key topics regarding the politics of employment-friendly welfare reforms. Our main focus will be on continental regimes, since their employment-friendliness is the most strongly challenged in the post-industrial context, whereas the Nordic and liberal regimes succeed rather well with regard to their employment-performance. In the concluding part of the article, we summarize major axes for future theorizing and research.

1. A new context: the transition to post-industrial economies and societies

The linkages between labor markets and welfare state policies depend on the economic and social context. This context has changed profoundly over the last 30 years. Since the 1970s, the industrial economies have developed into very different post-industrial employment-patterns. Hence, welfare policies that may have been employment-functional in an industrial era may become employment-dysfunctional in a post-industrialist era. More generally, the linkages between welfare policies and labor markets must be contextualized.

1.1. Multiple pressures on post-industrial labor markets: globalization, de-industrialization, and demographic changes

While there is wide agreement in the literature that the economic and social context of western welfare states has changed dramatically over the last 30 years or so, there is still much ongoing controversy concerning the actual *sources* of these changes. In the following, it is argued that there are three main post-industrial developments – globalization, de-industrialization and socio-structural change – that challenge national labor markets and welfare states.

The economic literature conceptualizes *globalization* mostly in terms of growing trade openness (see e.g. Scharpf and Schmidt 2000), capital market openness (e.g. Garrett and Mitchell 1996, Garrett 1998) or increased global competition in terms of price levels (e.g. Crotty 2003), wages (e.g. Esping-Andersen 1996) or taxes (e.g. Tanzi and Schuknecht 2000, Steinmo 2002). Intriguingly, both the hypotheses and the existing evidence on the impact of economic globalization on labor markets are mixed and not conclusive. Different authors expect either a strengthening of the specificities of national production regimes (e.g. Hall and Soskice 2001, for early forerunners, see Katzenstein 1984, Gourevitch 1986) or a growing convergence of national labor markets and (liberalized) welfare states (Mishra 1999). Similarly, the results remain scarce, so far. It is rather uncontested that the processes of globalization have contributed to deindustrialization and the economic downturn in western economies after the 1970s. Whether these developments lead to particular policy responses, notably in the direction of deregulation and retrenchment, however, is far from obvious. A large literature doubts that globalization eclipses national (welfare) state capacity (see e.g. Garrett 1998, Boyer and Drache 1996, Evans 1997, Leibfried and Rieger 1998, Castles 2004, in a different vein, see Mishra 1999). Similarly, empirical studies (Garrett and Mitchell 1996, Burgoon 2001) find no or only very weak evidence for a direct negative impact of trade openness on social spending in the OECD (for an extensive annotated bibliography on globalization, see Rieger and Leibfried 1995). Hence, there is indeed

an agreement that increasing openness leads to a more volatile economy and thus challenges contemporary labor markets, but it is an open question to know how welfare states should or do react to these challenges.

Iversen and Cusack challenge the globalization-literature head-on (1998). In their words, they "believe that the main sources of risk (in the labor market) are to be found in domestic economic processes" (1998: 10), more precisely in the structural transition from an industrial to a service-economy, driven by technological change, progressive market saturation and shifting patterns of demand. *De-industrialization* is indeed the second major source of labor market changes that appears strongly in the literature (see in particular Esping-Andersen 1993, 1999, and Iversen and Wren 1998 on the "service sector trilemma"). The literature in this field argues that de-industrialization has profound impacts on the functioning of the labor markets. A service economy provides ample labor demand for very high-skilled and unskilled work, but fewer job opportunities for middle-level skills (Wright and Dwyer 2003). Furthermore, the rise of service sector jobs and changing production modes go along with the spread of atypical and flexible work contracts. These changes pose forceful challenges to the industrial welfare states.

In addition to globalization and de-industrialization, the *social modernization* since the 1960s (see e.g. Esping-Andersen 1999, Pierson 2001) is a third structural trend that transforms the pre-conditions for employment-friendly welfare states. Two major trends are particularly relevant for labor markets and welfare states: demographic ageing and changing gender roles. An increasing literature (see e.g. Castles 2004, Myles and Clement 1994, Esping-Andersen et al. 2002) documents demographic ageing and its twofold consequences in terms of labor markets: on the one hand, the lack of younger generation workers will prompt a need for additional labor supply. On the other hand, the wealth produced by the active generation needs to finance an ever growing non-active population. The change in gender roles is partly linked to the declining fertility rates. In addition, higher female education levels and family instability contribute to the growing labor market participation demand of women (see e.g. Orloff et al. 1999; Orloff 2006). The implications for labor markets are evident and manifold: a spread of discontinuous and atypical employment curricula, claims for gender egalitarian arrangements in the workplace and growing needs to either redistribute or professionalize care work.

The three trends of *globalization, de-industrialization and social modernization* create a new post-industrial labor market characterized by lower stability, different skill-requirements, pressure for financial sustainability and a new distribution of work between men and women. These new labor markets clash with welfare states that are designed to match industrial employment patterns.

1.2. A growing tension between post-industrial labor markets and industrial welfare states

Post-industrial labor markets have become more precarious, more feminized, more unequal and older (Sarfati and Bonoli 2002). The fit or misfit between welfare state institutions and labor markets has thus become a prominent issue in the welfare state literature (see e.g. Sarfati and Bonoli 2002, Esping-Andersen 1999, 2004, Huber and Stephens 2001). The following list presents a selection of some of the major post-industrial developments that challenge the employment-friendliness of welfare states in specific ways.

- *Massive unemployment* since the 1970s: high rates of structural unemployment and labor-shedding strategies, such as early retirement (Ebbinghaus 2006), have dramatically reduced the labor market participation rate, especially in continental Europe. The low labor market participation rate becomes a particularly threatening problem for those countries that rely on employment for the financing of the welfare state, i.e. the continental regimes. In addition, the shift from industry to services as the major sector of employment puts into question the

existing educational and skill-regime that was designed to enable workers to participate in the industrial economy (see e.g. Iversen and Cusack 1998, Estevez-Abe et al. 2001, Hall and Soskice 2001, Thelen 2004). Educational and training systems need to be adapted to provide employees with adequate skills and re-qualification. The literature on *active labor market policies* and *activation* (see e.g. Clasen and Clegg 2006, Schmid 2002) deals with this first category of employment-friendly reforms.

- *Difficulties for outsiders to enter the labor market*: Labor markets and standard employment are strongly protected in the continental welfare states. It can be argued that this arrangement was functional for the efficiency of a coordinated market economy in the industrial age (Estevez-Abe et al. 2001, Iversen 2005). In the recent context characterized by structural unemployment and the growth of labor market participation demand by women, however, strong employment protection may become particularly harmful to job creation and may drive a wedge between the interests of labor market "insiders" and "outsiders" (Rueda 2005, Saint-Paul 1996). In this respect, an employment-friendly welfare state is likely to pursue specific policies to support *outsider activation* and *employment for the young* (Schmid 2002, Wilthagen and Rogowski 2002).
- *Spread of atypical/precarious work*: De-industrialization and the entry of women in the labor market have led to a spread of atypical employment (see e.g. Talos 1999, Ferrera et al. 2000). The spread of flexible work raises welfare state issues: employees in atypical employment relations face a stronger risk of low incomes and poverty. In addition, the spread of flexible employment challenges certain welfare arrangements that penalize non-standard employment. Hence, an employment-friendly welfare state would tend to *encourage such forms of labor, but also provide new protection for these new types of jobs*. Denmark and the Netherlands have probably become the most prominent example of such a "*flexicurity*"-strategy (Visser and Hemerijck 1997, Ferrera et al. 2000, Bredgaard et al. 2005, Klammer 2005, Sperber 2005, Wilthagen 2002, 2003).
- *Rising income inequality*: As outlined above, the spread of post-industrial jobs leads to an increasing accent on particularly high- and low-skilled employment profiles (Wright and Dwyer 2003). Scharpf and Schmidt (2000) and Iversen and Wren (1998) stress a similar point, when arguing that full employment in a post-industrial economy necessarily comes at the price of greater income inequality. The trend to rising inequality is likely to become most pressing in the Nordic and liberal worlds of welfare. In the Nordic welfare state, the new production structure may clash with the tradition of wage equalization (Pontusson and Swenson 1996, Clayton and Pontusson 1998). In the liberal world, the major problem is the rise in numbers of "working poor" (Esping-Andersen 1999, Simmons 2004). An employment-friendly welfare state, i.e. a welfare state that supports full employment and well-functioning labor markets must provide adequate instruments for *poverty prevention* among the working population and/or adapted instruments of wage equalization.
- *Feminization of the labor force*: The entry of women in the labor force hits different welfare regimes in different ways (Esping-Andersen 1999, Huber and Stephens 2001). Already in the industrial age, women's labor market participation rates have been much higher in the liberal and Nordic welfare economies than in continental Europe, where female employment rates tend to be significantly below 60% (Gornick et al. 1996, Gornick and Myers 2003). This low female labor market participation was perfectly functional in the industrial era: it ensured full employment (Iversen and Wren 1998) and allowed to preserve the social and normative ideals of a male breadwinner society (Naumann 2005, Lewis 1993). In the post-industrial era, however, the male breadwinner institutions clash with both economic needs and normative values. An employment–friendly welfare state favors policies that allow the *conciliation of work and care obligations* for parents by means of family and labor market policies, in order to increase the labor market participation of women (Gornick et al. 2003, Estevez-Abe 2006).

From the 1980s onwards, the welfare states thus confront the need for employment-friendly recalibration (see e.g. Esping-Andersen et al 2002, Ferrera et al. 2000) and new social risk policies (see e.g. Bonoli 2005, Armingeon and Bonoli 2006, Taylor-Gooby 2004) in the areas of *activation* (incl. transitional labor markets, outsider activation, youth activation etc), *flexicurity*, the *conciliation of work and care* and *poverty-relief for the working poor*. At the same time, however, resources become scarce, so that all welfare states start attempts at – highly unpopular - financial consolidation and retrenchment (Pierson 2001). Hence, post-industrial welfare states are confronted with two contradictory pressures: there are demands for expansive welfare reforms in an era of austerity. In this difficult context, the *politics* of post-industrial reforms become the focus of much of the welfare state research: The primary question is not what needs to be done, but whether reform is possible at all? What are the relevant conflict lines? Who will be the key actors of post-industrial welfare reform?

The literature on these questions can be divided in two strands: a first strand focuses on the more general *reform-capacity* of institutionally mature welfare states (section 2), whereas a second strand deals with *regime-specific politics* (section 3).

2. The new politics of the welfare state: Can mature welfare states adapt to post-industrialism?

The need for employment-friendly welfare state reforms in a context of austerity has fostered a wide and influential literature on the question whether mature welfare states can be reformed, at all. At first, this "new politics of the welfare state"-literature (Pierson 1996, 2001) dealt almost exclusively with the question of welfare retrenchment, which is not the core of this paper. But the retrenchment-literature does have some relevance for our topic, since much of the more recent literature points to the *link* between retrenchment and expansive employment-friendly "recalibration". The argument of the early "new politics"-literature was that over time, welfare reforms become increasingly difficult, since the mature welfare states themselves create the constituencies that are likely to oppose such restructuring. Thereby, welfare state institutions endogenously transform the politics of reform over time. The new politics of the welfare state (Pierson 1996) would thus differ from the "old" pattern of class politics, which opposed left-wing welfare supporters to right-wing liberals. In the new context, it was argued, ever increasing ranks of welfare beneficiaries would mobilize for their acquired rights and create a cross-class coalition of status quo-defenders almost impossible to surmount in democratic regimes. A wide literature subsequently analyzed these obstacles for reform (e.g. Pierson 2001, Esping-Andersen 1996, Myles and Pierson 1997, Hacker 2002). In response to the "new politics"-argument, two main answers appeared in the literature: Firstly, a strand of literature close to power resources argues that the basic pattern of class- and party-led reform orientations still holds (Korpi and Palme 2003, Green-Pedersen 2001). And secondly, a more recent literature specifies the conditions under which even highly unpopular reforms may indeed take place in advanced welfare states (Streeck and Thelen 2005, Hacker 2002). This second strand of literature deals more directly with the politics of welfare state transformation and recalibration.

In this *debate on welfare state restructuring and recalibration*, we identify two areas of research, in which many open question on the emerging patterns of politics still persist:

- *What are the conditions for the implementation of "unpopular" reforms?*

Unpopular reforms comprise retrenchment of benefit levels, but they also refer to employment-friendly reforms such as re-commodification and labor market flexibilization. Many of these reforms have been implemented in Western Europe over the last decades and they challenge the neo-institutionalist claim of stasis and path-dependency. Several explanations exist, but they have not yet been tested systematically and explicitly against each other. Pierson himself argued that

restrictive reforms can only be implemented by political leaders against the constituencies of beneficiaries, if the consequences of the reforms are non-transparent or obfuscated (1996, 2001). However, there have been many very significant reforms over the last years, some of them highly mediatized and heatedly debated in the public arena. Alternative explanations for these reforms appeared in the literature: Bonoli and Palier (2007) argue that structural changes are based on accumulation of a series of reforms in which retrenchment reforms strategically exempt particular groups from negative consequences (e.g. pensioners). Somewhat similarly, Bonoli (2001), Levy (1999) and Häusermann (2006, 2007) argue and show that retrenchment reforms tend to be strategically tied packages ("modernizing compromises", Bonoli 2001) that divide the (potential) opponents of a reform, by providing them with selective compensations. Finally, Kitschelt (2001) argues that "unpopular" reforms are implemented by governments who face little "electoral threat", i.e. they have no competitor who might credibly defend a pro-welfare position. This last argument comes close to the "Nixon goes to China"-logic, developed by Fiona Ross (2000). Hence, many hypotheses are on the table, but there is no explicit testing of these hypotheses against each other and no conclusive evidence on the determinants (political parties, ideas etc.) of unpopular reforms, such as retrenchment or labor market flexibilization.

- *The politics of recalibration:*

A different strand of reform analyzes the politics of employment-friendly reforms more directly, i.e. without referring to the wider context of austerity and retrenchment. What are the politics of welfare state recalibration in the direction of activation, flexicurity and work-care conciliation? One idea – which is similar to the argument on "modernizing compromises" in the retrenchment literature - can be found in the literature on "social pacts" (Rhodes 2001, Ebbinghaus and Hassel 2000). These authors observed that corporatist policy-making had not collapsed in the 1990s (as some had expected, see e.g. Schmitter and Grote 1997), but quite contrarily, had re-surfaced in several European countries, such as Italy, the Netherlands or Ireland (Rhodes 2001, Regini 2000, Ferrera and Hemerijck 2003), bringing about activation, flexicurity-policies and wage restraint in several countries. How could this happen? Generally this literature argues that the recent social pacts do not follow the same patterns as earlier corporatist pacts. This means that trade unions and employers are not the key actors anymore, because they are not able anymore to come to agreements through self-restraint and compromising. Rather, this literature argues, the new social pacts of labor market and welfare recalibration are the result of EMU pressure (Hancké and Rhodes 2005, Rhodes 2001, 2003), stronger state unilateralism (Hassel 2003, Rhodes 2000a, Ross 2000), and/or new types of concertation and negotiation (Ferrera and Gualmini 2000, Hemerijck and Visser 2000). Hence, the open question with regard to the recalibration-capacity of Western welfare states is whether employment-friendly recalibration is the result of rare and contingent favorable circumstances (such as EMU-pressure, technocratic government), or whether these pacts represent a new mode of policy-making in the post-industrial era (Avdagic, Rhodes and Visser 2005).

With regard to employment-friendly family-policy recalibration, rather similar questions have surfaced and remain on the agenda. Reforms aimed at balancing work and family life have gained momentum in many West European countries since the 1990s, and it has been observed that the politics of work-care conciliation do not correspond to the "old" patterns of class-conflict. Rather, these policies give rise to new coalitions of parties, employers and civil society organizations, and they are backed by EU legislation (Jenson and Sineau 2001, Ferrarini 2006, Orloff 2006, Häusermann 2006). However, it remains unclear so far whether these new coalitions are selective, or whether they reflect a pattern of politics that is going to last.

Overall, there remains a range of unresolved questions in the recalibration-literature: It is mainly unclear whether these reforms are exogenously induced by supranational legislation, whether they

are the result of strong governments and unilateral reforms, or whether they result from a new pattern of preferences and power-relations among traditional political actors.

In this section we have briefly reviewed two strands of literature that deal with the politics of welfare state restructuring and recalibration. From very early on, however, a wide literature has pointed our the fact that the post-industrial challenges to welfare states and labor markets will differ between the regimes (Huber et al 1999; Kitschelt et al. 1999, Scharpf and Schmidt 2000, Pierson 2001). Consequently, the politics of employment-friendly reforms also differ accross these regimes and the literature must be analyzed and discussed separately.

3. Different reform agendas, different politics

Comparative research published in the early 2000s has shown that each welfare and labor market regime has its specific vulnerabilities, in particular for maintaining employment (Scharpf and Schmidt 2000). If the challenges vary, so do the solutions: we can identify three approaches to reform, each of them reflecting the distinctive historical and institutional challenges of a particular social protection regime. Paul Pierson argues that the agenda of each regime is dominated by one type of welfare and labor market reform: in liberal regimes, reform is based on re-commodification; in social democratic regimes, reform is based on cost-containment; and in continental regimes, reform is based on recalibration, which adjusts social programs to new risks and needs (Pierson 2001: Conclusion).

Here, we will focus on the politics of employment-friendly welfare reforms. The discussions of the politics of reform in the three regime-types are structured similarly. We start with the identification of the key issues on the agenda of employment-friendly reforms, before reviewing some major open research debates on specific aspects of these reforms.

3.1. Nordic welfare states: Reinforcing a successful regime

The Nordic welfare states are characterized by high levels of social expenditure and taxes and by low levels of poverty, as well as low income and gender inequality. Therefore, they have been portrayed as "big and fat" welfare regimes (Kautto and Kvist 2002: 191). However, one of the keys to understanding Nordic welfare states is the very *high employment rate*, which is partly the result of a large public sector and activation policies. The high level of activation provides the means for the large scope of tax-financed welfare. Hence, since the welfare policies of the Nordic regimes aim at ensuring full employment of all adults by means of activation, work-care infrastructure and public sector employment, they can roughly be seen as the "employment-friendly pioneers" , which may inspire many of the employment-friendly reform attempts in other countries, notably the continental welfare states.

Nevertheless, there is a recent literature that discusses the *sustainability* of the employment performance in Nordic regimes. In the 1990s, the Nordic model became strongly challenged by a macroeconomic downturn. Unemployment rates in Sweden and Finland increased almost five-fold between 1990 and 1993 (Kautto and Kvist 2002), and the employment performance also declined in Denmark and Norway. In this context, some authors asked whether the Nordic welfare states would remain sustainable, or whether we should expect a race to the bottom, i.e. a downward convergence with the smaller welfare states in continental Europe and the anglo-saxon countries (Lindbeck 1997, Mishra 1999, Steinmo 2002, review in Kautto and Kvist 2002, for a skeptical viewpoint on these challenges, Huber and Stephens 1997). Indeed, some indications of major change in politics became visible, e.g. when the Swedish employers temporarily left the administrative boards of social policy governance (Pontusson and Swenson 1998, Pestoff 2002) So far, however, the convergence thesis has received very little support. In a

large research project, Kautto et al. (2001) show a) that there is a clearly recognizable Nordic model, b) that parallel developments with other (continental) countries remain limited and c) that there is no dismantling of the Nordic welfare states (Kautto et al 2001). Quite the contrary, the Swedish employment-centered welfare state has become a reference point not only for the EU and other Nordic states developing activation further (Kvist 2003), but also for the continental Welfare regimes seeking to implement employment-friendly reforms.

Hence, there is wide agreement, that after a short crisis in the 1990s, the Nordic regimes basically stick to their traditional road of welfare and even intensify it. However, several questions about the politics of reform remain debated in the literature. We identify three major questions about Nordic reform politics: a) What accounts for the strength and spread of activation policies? b) what are the main conflict lines in Nordic welfare reforms? More precisely, what is the role of the trade unions in the recalibration of welfare regimes towards employment-favoring policies? And c) a third debate deals with the actual sustainability of the Nordic model.

- *The spread of activation policies in the 1990s*

While Sweden has always been a pioneer in terms of activation policies (Dropping et al. 1999), these employment-centered reforms (here understood as active labor market measures) have spread massively in the other Nordic countries in the 1990s. At the end of the 1990s, Denmark and Finland had even overtaken Sweden as the front-runners in activation, with Denmark being particularly innovative and successful (Kvist 2003a). In terms of employment-friendly welfare reforms, the key question is of course how we can explain these reforms. The jury is still out on the question whether these policies are the result external constraints and problem load (Dropping et a. 1999), the particularities of the industrial structure (Goul Andersen 2007), ideational leadership by international actors (Hvinden et al. 2001) or more political factors such as coordination capacity and state strength (Martin and Thelen forthcoming).

- *Trade unions: new sectoral cleavages or encompassing "modernized" unions?*

A second major debate in the literature on the development of Nordic welfare state politics deals with the relevant cleavages for policy-making, and – more specifically – with the role of the trade unions. Much of the literature of the late 1990s (Iversen and Wren 1998, Pontusson and Swenson 1996, Notermans 2000) has pointed to a growing intra-labor divide between economic sectors sheltered from international competition (mainly the public and private service sector) and the economic sectors exposed to growing pressures for competitiveness (mainly the large manufacturing industry). The decline in Swedish corporatism in the 1990s (Pontusson and Swenson 1996, Pestoff 2002) points in a similar direction, because the employers of the large firms temporarily withdraw from the negotiation table. Similarly, other observers also point to newly emerging conflict lines that may divide the interests of labor (Sainsbury 1996 on gender conflict, Steinmo 2002 on the erosion of worker solidarity). However, the more recent literature points to a renewed success of the Nordic model, with reforms agreed upon by all major actors, including the union movement and the state (Martin and Thelen forthcoming)[3]. How can we explain persisting labor cohesion in the Nordic regimes? How did the Nordic trade unions manage to remain encompassing organizations in the context of post-industrialism? These are important questions, especially in the light of the growing intra-labor divides that are witnessed in the continental regimes.

- *The sustainability of the Nordic model*

[3] In addition, Ebbinghaus (2006a) shows that the Nordic union movement is still much more encompassing and representative in terms of skill-levels and gender than the continental unions.

Iversen and Wren in their article on the service sector trilemma (1998) point to the fact that low income inequality and full employment in a service economy may only come at a very high budgetary and fiscal cost. Therefore, Iversen and Wren expected that the Nordic model may put the interests of the high-productivity private sector against the interests of the low-productivity (public) service sector and thus lead to attacks against the high tax levels. Steinmo (2002) answers this debate by closely examining the Swedish tax policy since the 1980s. He finds that Sweden has indeed deeply reformed the tax system in the early 1990s, but in a way that did not dismantle the system, but broaden the tax base while at the same time lowering marginal tax rates for both workers and firms. Overall, the reform made the system less progressive and it could be seen as a threat to the Swedish welfare model. However, as Scharpf and Schmidt (2000) argued, the problem of sustainability is as much economic as political: the main question is whether citizens in the Nordic states are – and will remain - sufficiently satisfied with the public services to consider the high tax levels legitimate.

3.2. Liberal welfare states: from welfare to workfare

In the wake of Pierson's contributions (1994, 1996), much of the literature on liberal welfare states in the 1990s focused on the issue of reform capacity vs. institutional stability. Pierson had shown that even the right-wing governments in the US and the UK were unable to implement radical retrenchment, in times when they faced in principle very favorable political conditions to do so (context of crisis, right-wing ideology, firm majorities, weak unions). Hence, the focus of the literature was mostly on the reform (in-)capacity of liberal regimes and on institutional stability (Myles and Pierson 1997). With the development of the "third way" in the UK from 1997 onwards, however, the liberal welfare states – especially Britain – became the forerunners of "employment-friendly welfare reforms". The whole welfare state was largely reoriented towards extensive workfare schemes, intended to raise employment and to replace compensation by activation. With regard to the politics of workfare and the third way, Taylor-Gooby (2001) shows that they were clearly the result of a major political convergence of the Conservative and the Labor Party. Equally clear is the apparent "success" of these employment-focused policies in the sense that the liberal countries managed to achieve very high levels of activation[4] (for a critical view on the third way's effectiveness, see Clasen and Clegg 2004).

The orientation of liberal welfare states towards activation and social investment raises several important issues on the politics and consequences of this employment-focused strategy. We discuss two of them in the following.

- *Third way workfare policies aim ideally at a social investment state. What are the political dynamics of this development? What are the determinants of social investment?*

Third way politics insist on the individual opportunities / responsibilities, instead of rights. The underlying idea is what Lister (2004) calls a "social investment state", i.e. a state that enables citizens to care for themselves, rather than being cared for. The idea has been most strongly developed in the "New Deal" of the Blair government, providing jobs, education and training for unemployed people as a condition of receipt of benefits ("workfare"). However, the "make work pay" programs widen the gap between those in and out of work, because more means-tested support is directed to low-income families in work, while benefits are minimal for those out of work. What are the politics of social investment? The "Welfare to Work"-program of the Blair government was supported by British employers, while they opposed the minimum wage. Is the

[4] However, workfare and liberal labor market policies increased job performance, but they mostly produced jobs at the higher and very low end of the income distribution, squeezing out the middle classes (e.g. Wright and Dwyer 2003).

third way activation strategy only a different sort of neoliberal policy, framing retrenchment as an increase of individual responsibility and opportunity? Or is the social investment state a new *left* strategy to reconcile financial austerity with some sort of equality? Is it a way to "turn vice into virtue" (Levy 1999)? And will it become a larger paradigm for policy reform all over Europe, now that the EU has adopted the strategy and discourse (Jenson, Saint Martin, 2006)? On this debate, see also Lewis and Surender 2004 and – more generally - Green-Pedersen et al. 2001,).

- *Workfare in the liberal welfare states has the problematic side-effect of raising wage inequality, working poverty and precarious jobs. What are the politics of making workfare socially sustainable?*

Somewhat in contrast to the "neoliberal" convergence between the left and the right on the third way, Taylor-Gooby (2001, 2004) nevertheless shows that New Labor in Britain did increase provision for low-paid workers and low-income families (see also Taylor-Gooby and Pernille Larsen 2005). Labor also increased the less visible taxes for higher income groups and introduced a minimum wage. This resembles the "classic strategy" of a liberal welfare state, i.e. a reliance on means-tested minimum benefits for particularly vulnerable groups. What is particularly notable in terms of politics is that these improvements of redistribution are "granted" rather than achieved by the beneficiaries themselves. As Taylor-Gooby points out (2001), the victims of these trends are unable to gain a political voice within the institutional framework of decision-making in the UK.

3.3. Continental welfare states: the politics of regime transformation

Continental welfare states are the most challenged of all regime-types, because they are most severely hit by the "welfare without work" problem. In terms of Iversen and Wren's (1998) service sector trilemma, continental welfare states have long privileged wage equality and budgetary stability over full employment. Hence, employment levels in continental welfare states have become particularly low. Continental welfare states also display particularly low levels of female activity and an early "de facto" retirement age, due to extensive early retirement schemes and low labor market opportunities for the elderly.

To a large extent, continental welfare states thus cumulate all the typical problems of a post-industrial society (Esping-Andersen 1996): Social security is mostly provided through insurance schemes, which are financed by pay-roll taxes. Hence, low labor market participation undermines the stability of the welfare state. In addition, and in spite of the low female labor market participation rate, fertility is lowest in continental Europe, which also undermines the long-term stability of the PAYG-pension schemes. Furthermore, the policy implications of the male breadwinner model (lack of care infrastructure, derived instead of individualized rights etc.) are in plain contrast to the changing values and needs of a post-industrial society. Moreover, the social insurance architecture of the continental welfare state focuses on standard employment and fails to provide adequate social provision to "new risk" groups, such as atypically employed, young families etc. And finally, low female employment and strong horizontal and vertical gender segregation of the labor market impacts negatively on the economic performance of these countries. This list of the major strains on continental regimes indicates that the lacking employment opportunities are at the core of most problems of these welfare states. Hence, the question whether, how, and to what extent employment-friendly policies – activation, work-care conciliation, flexicurity - can be implemented is key.

Much of the literature has argued that the continental welfare states are "frozen", i.e. particularly difficult to reform (Esping-Andersen 1996, Pierson 2001). This is due to the very institutional architecture of these states, building on insurance, which is not only very legitimate in the eyes of the contributors, but also reinforces the power of the beneficiaries of existing schemes (Pierson 2001, Bonoli and Palier 2000). Since all contributors are stakeholders in the insurance regime,

they will have an interest in preventing change, so that reforms should be particularly difficult. In addition, activation and employment-friendly policies often target outsiders and new risk groups, who are particularly marginalized in continental welfare states (Clegg 2007). Consequently, much of the literature stresses the strong problem-load in continental Europe, and the particularly problematic circumstances for employment-friendly reforms (see e.g. Huber and Stephens 2001, Scharpf and Schmid 2000, Armingeon and Bonoli 2006, Esping-Andersen 1996, 1999).

Despite all these rather pessimistic, yet highly plausible explanations for inertia, a growing literature has emerged since the end of the 1990s documenting far-reaching changes in continental welfare states (see e.g. Palier 2002, Clasen 2005, Streeck and Thelen 2005, Bleses and Seeleib-Kaiser 2004, Palier and Martin 2007). Not only did most of them massively scale back existing rights in core policy field such as pensions or unemployment benefits (Schludi 2004, Clasen and Clegg 2006) but most of them also expanded employment-friendly policies by strengthening active labor market measures, flexicurity for atypical workers or external care infrastructure for working women (see e.g. Bleses and Seeleib-Kaiser 2004, Rhodes 2001, Hemerijck et al 2000, Gornick and Meyers 2003, Leitner et al 2004, Clasen 2005, Levy 1999). All these reforms seemed highly unlikely in the context of continental regimes. Consequently, they have triggered a large and growing literature on the change of political dynamics and politics in continental welfare states. In this literature, many different explanations of recent political dynamics exist, but most debates remain unsettled so far. In the following paragraphs, we give an overview of the state of several selected debates.

- *Which are the relevant conflict-lines in post-industrial continental welfare politics: class, insider/outsider status, gender, values? Are these newly observable conflict lines ephemeral or a deeper restructuring of the patterns of policy-making?*

There are several tentative explanations of the recent, highly unlikely, reform profile of continental welfare states. Some authors refer to the mere problem-load and to the ideational leadership of governments, convincing people of the need for cuts (see e.g. Kitschelt and Streeck 2003, Stiller 2007). Others refer to exogenous factors, notably pressure from the EU (Ferrera and Gualmini 2000a). However, many observers also note that the *conflict structure* in continental European welfare politics has changed. The recent reforms tend to be implemented by highly "unlikely" (cross-class) coalitions of actors. Several hypotheses exist with regard to the nature of these new conflict structures: Häusermann (2007) shows that labor unions and political parties tends to become more and more split with regard to insider/outsider-status, skill-levels and value-orientations. A progressive, high skilled left-wing constituency parts company with the rather conservative blue-collar workforce, the main clientele of the trade unions. Kitschelt and Rehm (2005) underline this finding by showing that the left (Social Democrats and trade unions) in continental Europe increasingly relies on an electorate with extremely heterogeneous welfare preferences. Rueda (2007) also stresses the importance of insider-outsider politics in employment policy reforms. Insiders claim employment protection, whereas outsiders claim active labor market policies. Hence, outsiders may become an ally of forces who want to reduce employment protection. Rhodes's (2001) argument on social pacts goes in a similar direction. Outsider policies have the potential to divide labor. In sum, employment-friendly reforms in continental regimes may divide labor and more generally the left and open new avenues to cross-class alliances. An additional open question is whether these new alliances correspond to punctual "ambiguous agreements" (Palier 2005), which are highly instable and ephemeral (e.g. Ballestri and Bonoli 2003), or whether they reflect a deeper reconfiguration of the underlying class structure (Oesch 2006, Kitschelt and Rehm 2005, Häusermann 2007).

- *Who are the winners and losers of the recent employment-friendly reforms (such as flexible labor markets, activation, flexicurity, female labor market participation)?*

Is the growing accent of the continental welfare states on outsider activation and new risk protection actually a welfare state expansion (Bonoli 2005, Häusermann 2007, Bleses and Seeleib-Kaiser 2004, Riedmüller et al 2000) or are these policies merely minor sweeteners to a trend towards retrenchment, growing inequality and precariousness (Clegg 2007, Palier 2002, Leibfried and Obinger 2003)? This question about the winners and losers of recent recalibration is at the core of a debate on the effects of recent reforms in terms of social stratification. Indeed, even though most continental welfare states have developed and extended their welfare support for the social groups most at risk (low-skilled, low-wage earners, young families etc), in the end they may still not be better off than people with similar characteristics 10-20 years ago. This debate relates, of course, to the question of welfare-reform measurement (Clasen and Siegel 2007). It is relevant to the understanding of recalibrating politics, because the distributional effects of these reforms feed back into subsequent reform processes.

- *What is the role of corporatism in continental welfare state reforms? Has it turned from an advantage to a liability? And why have the trade unions in some countries become "reformist" and inclined to employment-friendly policies, whereas they oppose the same reforms in others?*

For a long time, corporatism was seen as an integral part of the continental welfare states, ensuring reform-capacity and social peace, especially in small states (Katzenstein 1984) and in times of crisis (Gourevitch 1986). More recent studies, however, question the role of trade unions. Several studies (Ebbinghaus and Hassel 2000, Rhodes 2001, Kitschelt and Streeck 2003, Häusermann 2005) show that in various cases of employment-friendly policies, they have even become a major impediment for reform. Quite to the contrast, however, trade unions have been at the heart of the employment-focused reforms in the Netherlands (Visser and Hemerijck 1997). There is an unresolved debate on the role and strength of labor in these recent reforms. Why do they play such different roles in different countries? What factors does their position depend upon? There are some hints in the literature: Ebbinghaus (2006a) points to the selective representation of trade unions in continental Europe: women and service sector workers are strongly underrepresented, compared to the Nordic states. And Trampusch (2004) shows for Germany that the ties between party and union elites are becoming weaker. This may also contribute to changing the role of unions. Moreover, Ebbinghaus and Hassel (2000) argue that trade unions only cooperated in social pacts where the state was strong enough to threaten with unilateral intervention in case of the failure of negotiations.

Conclusion

The transition to post-industrialism has generated a range of new tensions between welfare state arrangements and labor market performance, which confront today's welfare states with new challenges for employment-friendly recalibration. In this article, we have discussed a wide range of literature that deals with the capacity of welfare states to adapt to these challenges, and with the political determinants of this adaptation process. The overview of this dynamically evolving literature shows that – contrary to the expectations of stasis and inertia that dominated the neo-institutionalist literature in the 1990s – there have been far-reaching changes in most welfare regimes, in the direction of employment-friendly policies such as flexicurity, activation, work-care conciliation and social investments. The Nordic welfare states are the champions of these policies, and their success in terms of both employment performance and social welfare also turns the spotlight on the politics of employment-friendly reform strategies in the liberal and continental regimes. However, both the reforms themselves and the research that analyzes their determinants are evolving rapidly and most research debates have not yet been solved. Therefore, we have outlined and discussed a range of research questions that we consider particularly relevant and fruitful avenues for future theorizing and research. In conclusion, we would like to summarize them briefly.

The literature on recalibration in a context of financial austerity shows that most re-commodifying and employment-friendly reforms in the 1990s and early 2000s have been the result of political dynamics and coalitions that differ from the old patterns of class politics (e.g. Rhodes 2001, Ferrera and Hemerijck 2003, Ebbinghaus and Hassel 2003). Divided trade unions, selective cross-class alliances and new party dynamics characterize these reforms. However, there remains disagreement on two issues: on the one hand, there are competing hypotheses whether these "new politics" are the result of external pressure, stronger unilateral state intervention or underlying electoral dynamics. And on the other hand, we still do not know whether the new alliances and coalitional dynamics represent a stable new pattern of recalibrating policy-making, or whether they are ephemeral and selective. Qualitative comparative research, and a stronger focus on the link between the changing socio-structural constituencies and actor positions in the policy-process could take this debate further.

Aside this general debate on recalibration-capacity, we proposed and discussed more regime-specific debates. The Nordic welfare states have so far been the most successful regimes in terms of employment-friendly policy reforms. Activation, flexicurity and work-care policies have spread massively, particularly in Sweden and Denmark over the 1990s (e.g. Kautto et al. 1999, 2001, Kvist 2003a), and the blooming job performance in these countries makes policy-makers and researchers in other regimes turn their eyes on the factors that explain the adaptation capacity of these welfare states. In terms of politics, it is striking to see that most of these reforms were adopted by large coalitions of state actors, parties, employers and encompassing trade unions (e.g. Kvist 2003a, Martin and Thelen forthcoming). The literature so far provides different explanations for this coordination capacity, referring notably to state strength, external pressure and the strategies of trade unions. Future research may put a focus on the interrelation and relative impact of these factors, in order to provide valuable lessons for the future and for other regimes.

Employment-friendly reforms took a particular form in liberal welfare states, relying on workfare first and a more encompassing approach of social investment later on, especially in the UK (e.g. Taylor-Gooby 2001, 2004, Lister 2004, Lewis and Surender 2004). In contrast to other regimes, these policies correspond to government strategies, rather than negotiated compromises. Given that the current policies feed back into future reforms, and also given that the EU is adopting a similar "social investment" policy orientation, it is important to assess the nature and distributional implications of these reforms, in particular for low-income groups. Is the social investment strategy a new way of overcoming the equality-efficiency trade-off, or does it widen the gap between the high-skilled workforce and the – politically voiceless –unskilled workers?

Continental welfare states struggle most strongly with the reorientation of their welfare states towards post-industrial labor markets. Employment-friendly reform politics not only deviate from the established logic of insider-oriented, male breadwinner welfare states, but they also blur established conflict lines. A wide literature shows that recalibrating reforms follow different logics of political division than "old" social insurance-reforms (e.g. Rhodes 2001, Kitschelt and Rehm 2005, Bonoli 2005, Häusermann 2007, Rueda 2007). In this respect, the salience of the insider-outsiders divide is certainly an important open research debate that should receive attention in the future. The literature is still scarce in showing who advocates insider- and outsider-interests, under what conditions they can be heard and how recalibration affects the balance of power between them. This is a key issue not only for explaining reform opportunities, but also for assessing the distributional implications of these reforms. In this respect particular attention should be given to the role of trade unions in organizing and advocating the interests of different constituencies of insiders, outsiders, women and the service sector workforce. A comparison with the encompassing union movement in the Nordic welfare regimes tends to suggest that the future of the work-welfare nexus in continental welfare states will depend strongly on the internal reform capacity of continental trade unions.

Finally, and this has not been the topic of our article, future research should pay particular attention to the distributional implications and effects of employment-friendly welfare reforms, because they bear very strong relevance for subsequent reforms. Indeed, reform processes are heavily influenced by policy feedbacks and learning processes. Hence, theories of policy reform dynamics must build on a deep understanding of the determinants and effects of preceding reforms.

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